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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning	)	Rulemaking 04-04-003
Order Instituting Rulemaking to Promote Consistency in Methodology and Input Assumptions in Commission Applications of Short-run and Long-run Avoided Costs, Including Pricing for Qualifying Facilities.	)	Rulemaking 04-04-025

COMMENTS OF THE UTILITY REFORM NETWORK ON THE

ALTERNATE PROPOSED DECISION OF COMMMISSIONER GRUENEICH

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September 10, 2007

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COMMENTS OF TURN ON THE ALTERNATE PROPOSED DECISION

Pursuant to Article 14 of the Commission's Rules of Practice and Procedure, The Utility Reform Network (TURN) hereby submits these comments on the Alternate Proposed Decision (APD) of Commissioner Grueneich regarding pricing and contracting for Qualifying Facilities (QFs) in California. TURN generally supported the Revised PD, which was distributed *circa* July 26, 2007, and particularly its emphasis on moving to market-based pricing for QFs. TURN submits that the APD contains some critical factual and technical errors that must be corrected, because they would result in payments to QFs that exceed the utilities' avoided costs.

In particular, TURN submits that the PD errs by: 1) adopting an SRAC formula that overstates the IOUs' actual short-run avoided energy costs, because it is based on a *simple average* of the IERs implicit in the existing transition formula and the implied market heat rates reflected in current market prices; and 2) failing to base the energy payment for firm QFs on the heat rate of the proxy unit (a combined cycle gas turbine – CCGT) used to derive the capacity payment. The latter error results in an "all-in" power price for firm QFs that exceeds the recommendations of every party in the proceeding (Table 7, p.98). Each of these errors will cause ratepayers to pay more than the utilities' avoided costs for QF power.

In addition, TURN submits that the APD requires clarification with respect to the definition of an "expiring" QF contract that would be eligible for one of the new contract forms adopted by the APD.

I. THE REVISED MIF FORMULA SHOULD NOT EMPLOY A SIMPLE AVERAGE

Yielding to some rather questionable arguments put forward by the QF Parties, the APD would move away from the purely market-based Market Index Formula (MIF) recommended in the Revised PD and instead adopt an SRAC formula that is based on a *simple average* of the

IERs implicit in the current transition formula (which were derived from data more than ten year's old) and the implied market heat rates reflected in current market prices. While TURN maintains that no "adjustment" to the original MIF approach is needed, the Commission should *at minimum* adopt an alternative that is more accurate and realistic than a simple 50/50 weighting of current market data and the extremely stale data underlying the transition formula.

TURN understands the motivation behind the APD's attempt at finding a compromise between the divergent positions of the QF Parties on the one hand and the IOU and consumer parties on the other hand, with respect to the appropriate determination of SRAC. However, the crude "split the baby" approach recommended in the APD does not achieve a balanced result and is not based on any discernable logic. Even if one accepts that the original MIF approach understates the utilities' avoided costs (which TURN does not), the record is undisputed with respect to the fact that the number of Reliability Must Run (RMR) contracts and out-of-market dispatches by the CAISO have *decreased substantially* in recent years as the result of this Commission's adoption of system and local Resource Adequacy Requirements (RAR). Thus, the APD's reliance on such factors to give a **50% weighting** to the 10+ year old IERs in the transition formula is in error.

If the Commission is nonetheless determined to provide SRAC payments at a level higher than current NP 15 and SP 15 market prices, TURN submits that a far better approach would be to adopt a **WEIGHTED AVERAGE** of the implied market heat rates derived from the original MIF approach and the IERs implicit in the old transition formula. Given the decreasing significance of the factors cited in the APD (such as RMR contracts and out-of-market dispatches), TURN recommends that the adopted weightings be no less than ***90%*** for current market prices and no more than ***10%*** for the old transition formula IERs. Such an approach would give some recognition to the factors cited by the QFs, while avoiding burdening ratepayers with grossly excessive QF energy payments that exceed the utilities' avoided costs. The 50/50 weighting of the new "market" and old "administrative" IERs reflected in the APD is not based on any evidence or realistic assessment of the significance of the impact that factors such as RMR and out-of-market dispatches may have on prices today. TURN's respectfully submits that a 90/10 weighting would more appropriately reflect the realities of today's energy market in California.

The APD would also employ a **24-month rolling average** of forward market prices for determining the MIF implied market heat rate. The IOUs have strongly opposed the use of such a long forward period because of the lack of liquidity in the forward market for transactions as far as two years out. TURN believes that the use **a rolling average of 12 months** of forward pricing data would be sufficient to capture seasonal variations, while avoiding reliance on thinly-traded markets more than a year out. Accordingly, TURN urges this Commission to modify the MIF approach to rely on only 12 months of forward pricing data.

II. THE ENERGY PAYMENT FOR FIRM QFs SHOULD BE BASED ON THE HEAT RATE OF THE PROXY UNIT USED TO SET THE CAPACITY PAYMENT, WITH NO DEDUCTION FOR ESTIMATED INFRAMARGAINAL RENTS

The APD adopts pricing for new *firm* QF contracts of up to 10 years in length, based on a capacity payment equal to the fixed costs of a new combined cycle plant (derived from the MPR formula), less an estimate of the inframarginal rents (energy revenues above variable costs) that would be earned in the energy market, along with an SRAC-based energy payment. ***This approach is seriously in error***, as should be apparent from the fact, demonstrated by Table 7 on page 98 of the APD, that the adopted illustrative "all-in" power price of 8.3 cents per kWh ***exceeds the highest figure recommended by any party***.

The problem with the APD's approach lies in the estimate of inframarginal rents (energy profits) of $21 per kW-year that the PD adopts on page 97, citing a figure provided by Southern California Edison in Exhibit 2 at page 73. A review of that exhibit (pp.73-75) makes it clear that the estimate of $21 per kW-year was calculated based on a simple-cycle combustion turbine (CT), ***not a combined cycle plant*** (CCGT). Because of its much lower heat rate, a CCGT would earn far more profits in the energy market than a CT. Thus, *the combination* of a capacity payment based on the higher capital cost of a CCGT reduced only by the energy profits of a CT, plus an energy payment based on an artificially high heat rate, would grossly over-pay a firm QF under this contract formula.

Given the paucity of record evidence regarding the actual energy rents that a modern CCGT would earn (and the variability of any such figures, given volatile energy markets), TURN submits that a far better method of pricing for firm QFs would be to provide ***both a capacity payment and an energy payment that are based on a modern CCGT***, the type of unit that a utility would most likely build or contract for "but for" the availability of baseload QF power. This would consistent of the $156.97 per kW-year *unadjusted* capacity payment, based on the MPR (APD, p.97), plus an energy payment based on the fixed heat rate of the MPR CCGT unit, which was 6,918 MMBtu/kWh, as recommended in the Revised PD at page 95 (*See* Res.E-4049, Appendix E, Row 6).

This approach – using the actual costs and operating characteristics of the "avoided" CCGT unit, based on MPR data – is far more reliable and accurate than any *estimate* of what the future energy profits of a new plant might be. It also more realistically reflects the likely structure of the payments that the utility would provide to such a plant under contract – a capacity payment covering the unit's fixed costs, plus a variable energy payment based on the unit's actual heat rate. This is the best measure of avoided cost over a longer timeframe such as 10 years, and eliminates the risk of gross overpayments that would be borne by ratepayers.

For all of the above reasons, TURN strongly urges this Commission to modify the pricing for firm QFs under the new contract form to provide for an *unadjusted* capacity payment based on MPR values, plus an energy payment based on the fixed heat rate of the proxy CCGT unit, also using the MPR value of 6918 MMBtu/kWh. Using the assumptions underlying Table 7 on page 98 of the APD, this would produce an "all-in" power price of about 7.25 cents per kWh for long-term firm QFs, very close to the recommendations of IEP and CAC/EPUC and only marginally below the figure derived from the PG&E/IEP settlement, which was 7.3 cents per kWh. The 8.3-cent figure that results from the APD's formula is clearly excessive, and substantially exceeds the utilities' avoided costs of building or contracting for a new CCGT unit.

III. A DEFINITION IS NEEDED FOR "QFs WITH EXPIRING CONTRACTS"

In several places (see, *e.g.*, pp.118-120), the APD states that the new firm and as-available contracts recommended therein would be available to "QFs with expiring contracts," without explaining exactly what is meant by the term "expiring contracts." Since every contract, including one that was just signed, will expire *someday*, TURN is concerned that this language could be interpreted as allowing *every* existing QF, even one whose contract may still have ten years to run, to enter into one of the new agreements. Such an interpretation would create chaos in the QF industry and potentially substantial administrative costs and complexity for the IOUs. Accordingly, TURN urges this Commission to define "QFs with expiring contracts" to mean those QFs whose existing contracts will expire ***within the next 12 months***. This will allow more than enough time to get new agreements in place, without opening up a wholesale "gold rush" of QFs seeking new contracts at the same time. In addition, QFs operating under the short-term contract *extensions* approved in recent Commission decisions would also be eligible for the new contracts, as provided in Finding of Fact 45 of the APD.

IV. CONCLUSION

TURN generally supports the Revised PD issued *circa* July 26, 2007. However, if the Commission prefers the APD, that proposal must be modified to correct the errors identified above. Absent such changes, the APD would force ratepayers to pay far more than the utilities' avoided costs for QF power, further exacerbating the extremely high retail rates that already exist in California.

Respectfully submitted,

THE UTILITY REFORM NETWORK

September 10, 2007

By: ______/S/_____________________

Michel Peter Florio
Senior Attorney

TURN’s Proposed Changes to the APD’s Findings of Fact

1) Delete Finding of Fact 19.

2) Modify Finding of Fact 23 by deleting the word “an” in the first line and by inserting in its place the words “a 90/10 weighted” before the word “average.”

3) Modify Finding of Fact 24 by inserting the words “12-month” before the word “forward.”

4) Modify Finding of Fact 37 by deleting the words “and firm” from the first sentence, and adding a second sentence to read: “Firm capacity payments will not be subject to a similar deduction because the heat rate in the firm contract will be tied to the heat rate of the MPR proxy CCGT unit, equal to 6918 MMBtu/kWh.”

CERTIFICATE OF SERVICE

I, Larry Wong, certify under penalty of perjury under the laws of the State of California that the following is true and correct:

On September 10, 2007 I served the attached:

COMMENTS OF THE UTILITY REFORM NETWORK ON THE

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on all eligible parties on the attached lists to **R.04-04-003** & **R.04-04-025**, by sending said document by electronic mail to each of the parties via electronic mail, as reflected on the attached Service List.

Executed this September 10, 2007, at San Francisco, California.

/S/

Larry Wong

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